



# **Alberta Heritage Savings Trust Fund**

**Annual Report**  
2011–2012



Heritage Fund



The mission of the Heritage Fund is to provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans.

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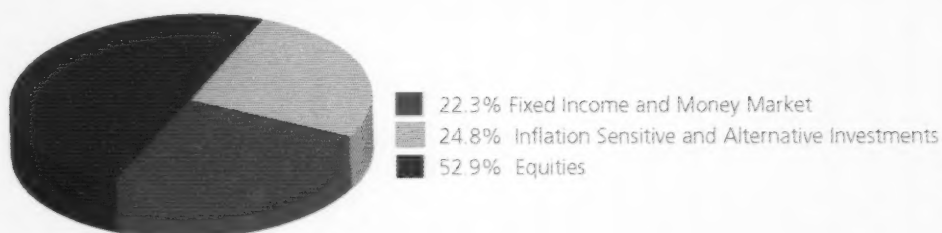
## FINANCIAL HIGHLIGHTS

	2011-12	2010-11
Total Fund (billions)	\$16.1	\$15.2
Total Income (millions)	\$798	\$1080
Income Transfer to GRF (millions)	\$344	\$720
Retained for Inflation Proofing (millions)	\$454	\$360

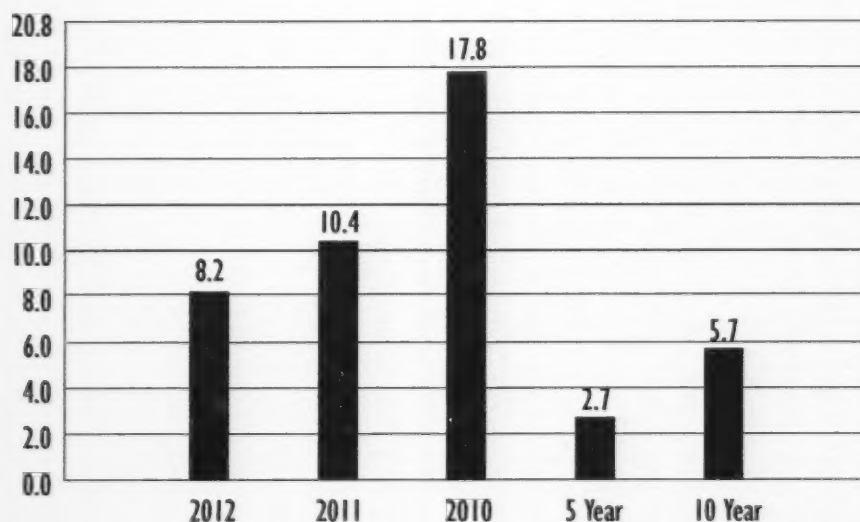
**\$16.1 BILLION**  
FAIR VALUE AT MARCH 31, 2012

**8.2%**  
RATE OF RETURN

### FUND INVESTMENTS AT MARCH 31, 2012



### INVESTMENTS RETURNS



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## Message from the President of Treasury Board and Minister of Finance

Long-term, global, well-diversified and prudently managed – these are terms that capture the investment approach for the Alberta Heritage Savings Trust Fund.

This balanced investment philosophy has enabled the Heritage Fund to accept a certain amount of risk to realize a greater return for Albertans over the longer term. The fund's recent performance, in spite of market volatility and the lingering European economic and fiscal crisis, confirms the fund is on the right path.

For the 2011-12 fiscal year, the Heritage Fund earned \$798 million - an 8.2 per cent return. The fund's global equity, interest-bearing securities and real estate holdings helped to offset the poor performance of the fund's Canadian equity holdings.

At March 31, 2012, the fund's fair value stood at \$16.1 billion, nearly \$800 million higher than last year. In addition to market trends, these numbers also reflect the value added by the fund's manager, Alberta Investment Management Corporation. The fund's performance in 2011-12 follows a solid 2010-11, which saw a 10.2 per cent return.

To protect the fund's value against inflation, \$454 million of the fund's income earned in 2011-12 was retained in the fund. The other \$344 million was transferred to general revenues to help pay for Albertans' priorities and keep taxes low.

While the fund has significant investments in Alberta and the rest of Canada, we do look abroad to the U.S., Europe, Japan and emerging markets like Chile, Brazil and China as well. In general terms, the fund's assets are invested in equities, interest-bearing securities and alternative investments, including infrastructure and real estate.

The Heritage Fund will continue to play an important role in Alberta's fiscal framework, saving money for future generations while supporting Albertans' priorities today. Going forward, government will be examining its fiscal framework, including the role of savings vehicles like the Heritage Fund. Albertans will have an opportunity to provide their input into this process, given the fund should reflect Albertans' priorities.

[Original signed by Doug Horner]

Honourable Doug Horner  
President of Treasury Board and Minister of Finance

# About the Heritage Fund

1976

Inception of Fund

Natural resource  
revenue transfers cut  
to 15% from 30%

1987

Natural resource  
revenue transfers  
halted

Government surveys Albertans  
on Fund's future. Survey results  
show Albertans strongly in  
favour of a Fund that generates  
long-term returns

1995

## What is the Heritage Fund?

The Heritage Fund is Alberta's long-term savings fund. Originally, the Fund was established to save a portion of Alberta's non-renewable resource revenue for future generations. Today, the Fund produces income which also supports government programs essential to Albertans such as health care and education.

## When was the Heritage Fund established?

The Fund was created in 1976.

At first, 30 per cent of Alberta's non-renewable resource revenue was transferred to the Fund. As Alberta experienced tough economic times in the early 1980s, this percentage was reduced to 15 per cent and eventually cut to zero in 1987.

After eliminating its accumulated debt in 2005, the Alberta government began putting money into the Heritage Fund again. This reinvestment came in part from the government's budget surpluses.

## What is the Heritage Fund worth today?

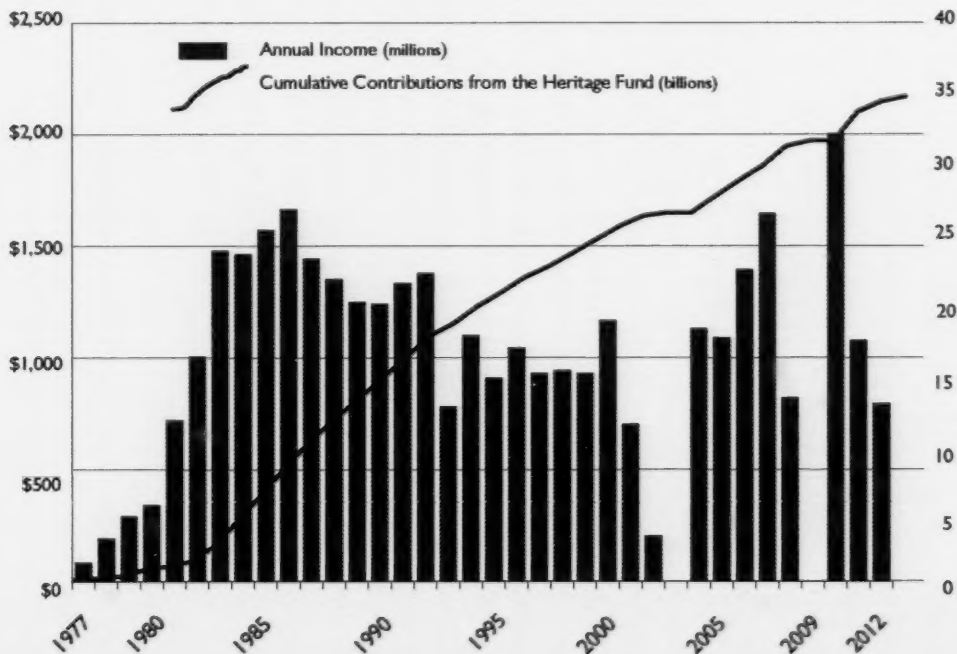
The Heritage Fund was worth \$16.1 billion as of March 31, 2012.

## What happens to the income earned by the Heritage Fund?

The Fund's legislation provides that it retain a portion of its income as protection against inflation. The remaining income is transferred to the Province's General Revenue Fund. These transfers from the Heritage Fund help keep taxes low and pay for priority programs.

In 2011-12, the Heritage Fund provided \$798 million in revenue for Alberta, \$454 million of which was retained in the fund for inflation proofing.

Over the past 36 years, \$33.4 billion from the Heritage Fund has supported spending in areas such as health care, education, infrastructure, debt reduction and social programs.



1997

Heritage Fund restructured:  
Economic and social development  
mandate ended as Fund is  
now only for long-term return  
generation. Standing Committee  
of the Legislature implemented to  
oversee Fund

Legislated inflation-proofing begins:  
\$384 million retained in fiscal 2006

2006

2007

Government completes  
\$1.0 billion commitment for  
Access to the Future Fund.  
Government contributes an  
additional \$1.0 billion from  
surplus for second year in a row

Heritage Fund records  
income of \$798 million

2012

In the graph on the previous page, the vertical bars show the annual investment income earned by the Fund in each of the past 36 years (in millions). The horizontal line shows the cumulative amount provided by the Fund for program and capital spending. As you can see, by 2012 the fund had contributed \$33.4 billion to support priority programs over the years.

#### How is the Heritage Fund invested?

The Fund's investment goal is to achieve a long-term financial return of 4.5 per cent above Canadian inflation, as measured by the Consumer Price Index (CPI). The investment plan is based on two important concepts: diversification to manage risk, and a long-term planning horizon to earn greater returns.

Half of the Heritage Fund's investments are in the stocks of private and public companies, with the remainder invested in bonds, real estate and infrastructure investments.

#### Who keeps track of the Fund's investments?

The President of Treasury Board and Minister of Finance is ultimately responsible for the Fund and its investments. The Department looks after the long-term strategy, developing investment policy and monitoring investment performance.

The purchase and sale of stocks, bonds and other investments for the portfolio is managed by Alberta Investment Management Corporation (AIMCo).

Four times a year, the President of Treasury Board and Minister of Finance reports to Albertans on the performance of the Fund. Within 90 days of the end of each fiscal year, the Minister releases the Fund's annual report.

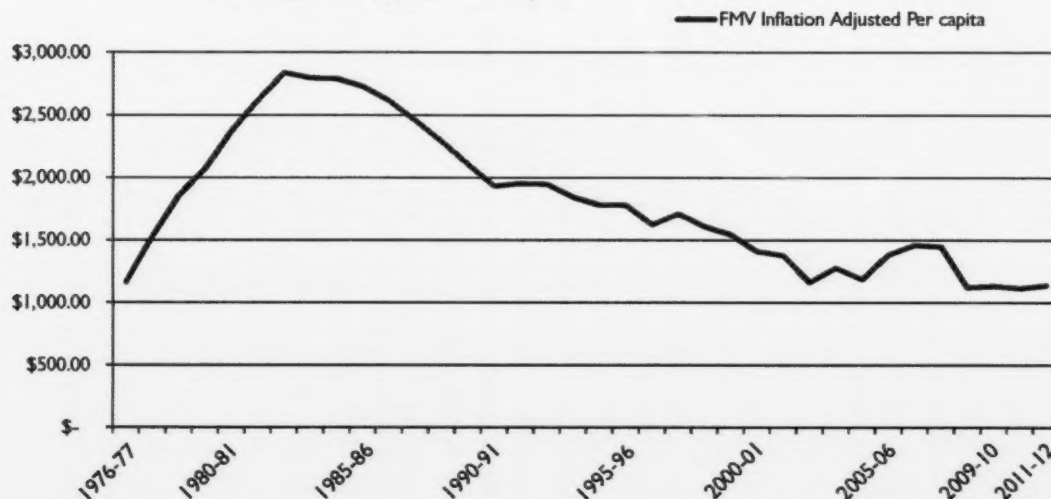
The Heritage Fund's business plan is published at the same time as the provincial budget.

#### What is the inflation-adjusted value of the Heritage Fund per Albertan?

As of March 31, 2012 the inflation-adjusted value of the Heritage Fund per Albertan was \$1,137. This is up from the previous year when the value was \$1,116 per Albertan on an inflation-adjusted basis. The highest value the fund ever had was in 1982-83 when it was \$2,840 per capita.

There are a few reasons the inflation adjusted amount has decreased over time. Since the inception of the Fund in 1976, inflation has been about 300 per cent, meaning what cost \$1 in 1976 would now cost \$4. Also, since the inception of the Fund, Alberta's population has more than doubled.

FMV Inflation Adjusted Per capita





# Alberta Heritage Savings Trust Fund Governance

The Fund operates under the authority of the *Alberta Heritage Savings Trust Fund Act*. The Act created the Standing Committee on the Alberta Heritage Savings Trust Fund to oversee the management of the Heritage Fund. The act makes the President of Treasury Board and Minister of Finance responsible for managing the Fund's investments.

The Standing Committee on the Alberta Heritage Savings Trust Fund is an all-party committee of the Legislative Assembly and is responsible under the act for approving the Heritage Fund's annual business plan and annual report.

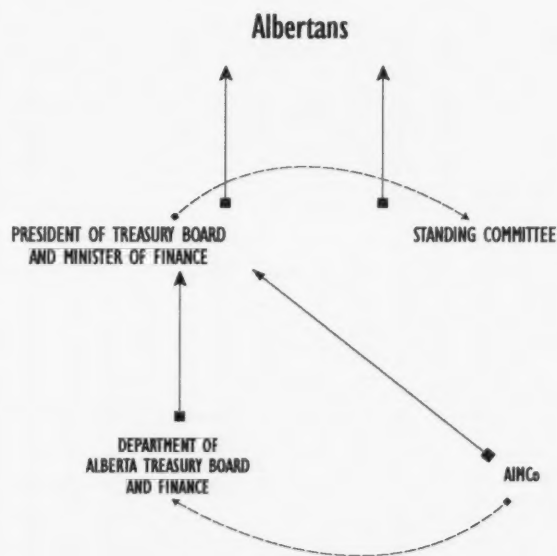
The Committee is required to review the performance of the Heritage Fund and report to the Legislature as to whether the mission of the Heritage Fund is being fulfilled. The Committee holds a public meeting annually. The most recent annual meeting was held in October 2011 in Edmonton and was televised for the second time.

The President of Treasury Board and Minister of Finance is responsible for making sure the Heritage Fund is invested in a prudent manner to avoid undue risk of loss and to obtain a reasonable return that will enable the portfolio to meet its objectives. The act also requires the Minister to make investments with the objective of maximizing long-term financial returns.

The Minister is supported in various aspects of the investment management process for the Heritage Fund by two groups: Treasury Board and Finance and Alberta Investment Management Corporation (AIMCo).

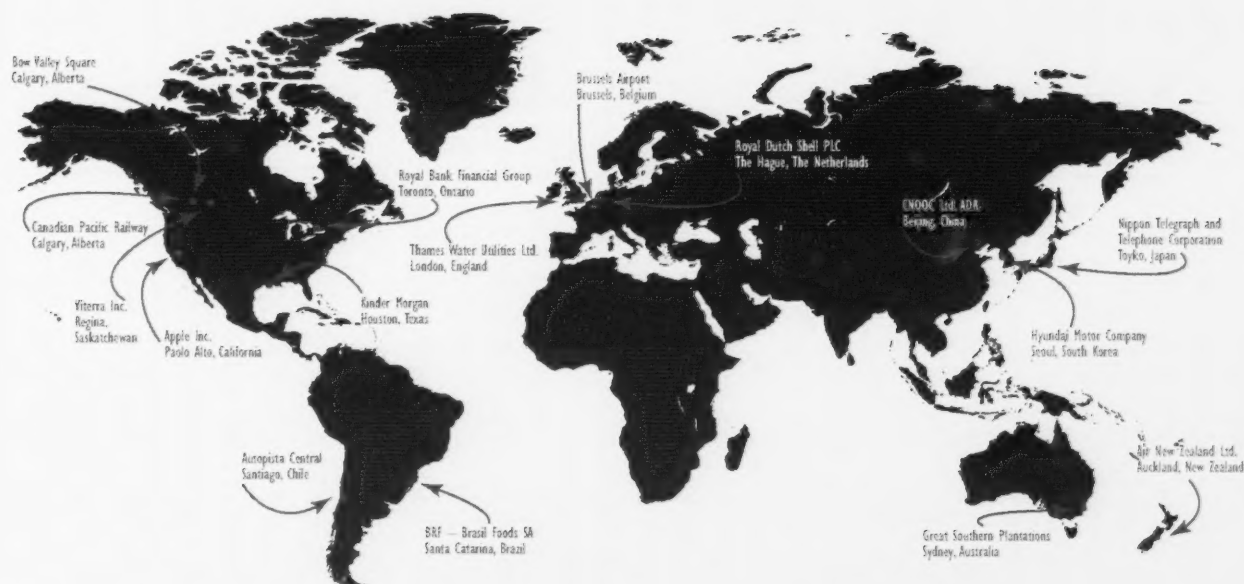
Alberta Treasury Board and Finance is responsible for developing the Statement of Investment Policies and Guidelines for the Heritage Fund, and for conducting ongoing research and analysis of asset allocation and risk management for the Fund.

AIMCo is responsible for managing the investments of the Heritage Fund in accordance with the Statement of Investment Policies and Guidelines. AIMCo is a provincial corporation, headquartered in Edmonton and governed by a Board of Directors that includes senior business and investment management leaders.





# Portfolio at a Glance



## Portfolio Construction

In order to achieve the return objective, the Fund is invested in a globally diversified portfolio of assets. Diversification is the key tool by which risk is mitigated in the portfolio. The Fund holds many different assets that should react differently in a wide variety of market environments. In simple terms, the Fund does not put all of its eggs in one basket.

The President of Treasury Board and Minister of Finance approves the Statement of Investment Policies and Guidelines for the Fund. Within this document is the Fund's target policy portfolio. The policy portfolio provides a guideline for investment strategies available to the Fund. This base portfolio is determined through extensive financial modeling by the Department and gives the province the ability to manage risk and position the Fund to meet return targets over time.

Some key highlights of the policy portfolio are:

- The Fund has target allocations to three broad categories: Equities, Fixed Income, and Inflation-sensitive and Alternatives. Both at the broad category level and at the asset class level, there are wide ranges around the strategic allocation targets that give AIMCo the freedom to actively manage the portfolio and add value.
- A move towards more non-Canadian assets: Canada only represents approximately five per cent

of the world's capital markets. While some of the best companies on the globe are Canadian, there is also opportunity outside our borders. This is especially true in faster-growing, emerging markets in Asia and Latin America. Investing in many different countries and currencies also provides diversification benefits.

- A move towards more long-lived assets: The policy portfolio for the Fund calls for significant increases to real estate and infrastructure. Because the Fund has a long-term horizon, it can afford to hold longer-lived or illiquid assets. Also, real estate and infrastructure generally offer stable long-term cash flows and some measure of inflation protection, which are important for the Heritage Fund.

## Active Management

AIMCo has the mandate to actively manage the Fund's portfolio within the parameters of the investment policy. AIMCo is expected to use their expertise to find investments that will beat normal market returns over time. The active management target for the Heritage Fund is an additional one per cent on top of the return on the long-term policy benchmark.

Active management can also be a source of risk mitigation: some investments are selected to help diversify the portfolio, or because they carry lower risk than the market as a whole.

## How the Fund is Invested

The Heritage Fund has a long-term objective of achieving a rate of return of 4.5 per cent over the Canadian rate of inflation. The Government of Alberta has determined that this objective is achievable while maintaining risk at a prudent level of risk.

### Key Investment Risks

At a broad level, the investment strategy is to take a series of calculated risks that will pay a premium over time. Different categories of investments have different risks. The types of risk that the government takes in managing the portfolio include:

- *Equity risk:* Holding investments in a market like equities is riskier than holding investments in provincial bonds or Canadian government bonds. Investors expect a premium to bear this risk. Historically, this premium has averaged between two and five per cent over a long period of time.
- *Credit risk:* The promise to pay from an entity like a corporation or municipal government may be less secure than the same investment in the Government of Canada. Therefore, such entities must pay investors a premium over Government bond rates to make this risk more attractive.
- *Liquidity risk:* Some investments, like a Government of Canada bond, can be sold immediately with little or no adverse effect on the price. This is not the case for many other types of investments such as real estate, private equity or hedge funds, whose value can be diminished if they must be sold at the wrong time. These investments are referred to as illiquid and carry the risk that they might not be able to be sold at a reasonable price in the event of an immediate need for cash.
- *Interest rate risk:* Interest-bearing securities, like bonds, face the risk that market interest rates will rise. As interest rates rise, the market value of a bond held in a portfolio will fall.
- *Inflation risk:* An increase in inflation will erode the purchasing power or real value of the Heritage Fund. The Fund deals with this risk in two ways. The first is the legislated inflation-proofing, meaning a portion of the Fund's income is retained in the Fund to help ensure it does not lose real value over time. The second is by holding assets that provide protection from inflation, such as real estate and infrastructure.
- *Country risk:* Making investments in foreign countries carries with it a risk of political instability, unpredictable monetary and capital market policy or the potential of sovereign default. Any of these things can reduce the value of an investment. Even developed nations, such as Ireland and Greece, have seen an increase in this risk in recent years as the world deals with the fallout from the global recession and credit crisis. The fact remains, Canada only represents approximately five per cent of the world's capital markets. By investing outside of Canada, the Fund has much broader opportunities for investments and diversification.
- *Currency risk:* Making investments in currencies other than the Canadian dollar exposes the portfolio to the risk of the Canadian dollar appreciating against that currency. If that happens, then as income is received or the investment is sold, the proceeds are converted back into Canadian dollars at a reduced amount, thus eroding the investment's value. Risk is taken into consideration by the government when investing outside Canada, but the government believes that it benefits from currency diversification.

## The 2011-12 Year in Review

The Fund earned net investment income of \$798 million for the year ended March 31, 2012. Of the total net income earned this fiscal year, \$454 million was retained in the Fund to protect it from inflation. The remaining, \$344 million was transferred to the General Revenue Fund.

The actual net income for the year was less than the budgeted income by \$172 million, which was primarily due to weaker than expected equity market returns. The 2011-14 Alberta Heritage Saving Trust Fund Business Plan forecasted Income of \$970 million after expenses of \$80 million. The business plan also forecasted transfers to the GRF of \$631 million and \$339 million to be retained in the Fund for inflation proofing. .

As of March 31, 2012 the Fund had a total net asset fair value of \$16.1 Billion, while the fund's value at cost was \$14.7 billion. Of the total fair value, 52.9 per cent or \$8.7 billion was invested in Equities, 22.3 per cent or \$3.7 billion was invested in Fixed Income and lastly 24.8 per cent or \$4.1 billion was invested in Inflation-sensitive or Alternative assets.

The table below summarizes the overall change in the net assets of the Fund.

CHANGES IN NET ASSETS (in millions)	Budget	Actual for the year ended March 31,	
		2012	2011
Investment income	\$ 1,050	\$ 897	\$ 1,152
Investment expenses	(80)	(99)	(72)
<b>Net Income</b>	<b>970</b>	<b>798</b>	<b>1,080</b>
Transfers to the GRF	(631)	(344)	(720)
<b>Net income retained in the Fund</b>	<b>\$ 339</b>	<b>454</b>	<b>360</b>
Cost of net assets, beginning of year		14,198	13,838
<b>Cost of net assets, end of year</b>		<b>14,652</b>	<b>14,198</b>
Accumulated unrealized gains		1,440	992
<b>Fair Value of Net Financial Assets</b>		<b>\$ 16,092</b>	<b>\$ 15,190</b>

## INVESTMENT INCOME

The gross investment income for the year ending March 31, 2012 was \$897 million. The investment income was dominated by three sources for the 2011-12 fiscal year. Global Equity, Interest Bearing securities, and Real Estate provided the most income for the Fund this year. Global Equity generated \$319 million before expense in income, while Interest-bearing securities provided \$275 million and Real Estate generated \$205 million. These three asset classes generated 89 per cent of the total income generated this year.

Total income generated was down 22 per cent from the previous year due to weaker performance in the equity markets. Equity markets generated \$404 million in 2011-12 versus \$749 million the previous year. Both Interest bearing securities and Inflation-sensitive and Alternatives generated more income than the previous year.

### NET INCOME BY ASSET CLASS (millions)

	2012	2011
Fixed Income	\$ 275	\$ 259
Equities		
Canadian	41	288
Global	319	409
Private	44	52
	<u>404</u>	<u>749</u>
Inflation Sensitive and Alternatives		
Real Estate	205	106
Infrastructure	(1)	29
Timberland	9	2
Private debt	4	-
Real return bonds	1	7
	<u>218</u>	<u>144</u>
Total	<u>\$ 897</u>	<u>\$ 1,152</u>

## INVESTMENT EXPENSES

Investment expenses for the 2011-12 fiscal year were \$99 million, which was 37.5 per cent higher than the previous year. Expenses came in 23.8 per cent higher than the \$80 million that was forecasted in the business plan.

Of the \$99 million in expenses, \$63 million can be attributed to the Equity portfolio as well as \$22 million to the Inflation-sensitive and Alternatives asset class, which were both higher than the previous year's expenses of \$45 million and \$17 million respectively. Investment administrative expenses were \$9 million for the 2011-12 fiscal year.

### INVESTMENT EXPENSES (millions)

	2012	2011
Interest-bearing securities	\$ 5	\$ 3
Equities	63	45
Inflation Sensitive and Alternatives	22	17
Investment administration expenses	9	7
Total Investment expenses	<u>99</u>	<u>72</u>
Average Fair Value of Investments	<u>\$ 15,951</u>	<u>\$ 14,915</u>
Per cent of investments at average fair value	<u>0.62%</u>	<u>0.48%</u>

## INVESTMENTS

On April 1, 2011 a new Statement of Investment Policy and Guidelines (SIP&G) was approved by the Minister and provided to AIMCo for implementation. The SIP&G contained a new asset mix that is currently being adopted. The eventual target is to have 20 per cent in fixed income, 30 per cent in Inflation-sensitive and Alternatives, and 50 per cent in Equity. This asset mix was designed to deliver the long term returns needed to allow the Fund to meet its obligation now and in the future.

Through both investment returns and new deployment of capital, the Fund has increased its Equity holdings and Inflation-sensitive and Alternative Investments. These increases were funded out of Fixed Income.

ASSET MIX	March 2012	March 2011	Policy range
<b>FIXED INCOME AND</b>	<b>22.3%</b>	<b>26.3%</b>	<b>15-45%</b>
<b>MONEY MARKET (20%)</b>			
Deposits and short-term	0.6%	0.7%	0-25%
Bonds and mortgages	21.7%	25.6%	10-35%
Long bonds	0.0%	0.0%	0-10%
<b>INFLATION-SENSITIVE AND</b>	<b>24.8%</b>	<b>23.7%</b>	<b>15-40%</b>
<b>ALTERNATIVE INVESTMENTS (30%)</b>			
Real estate	15.4%	12.9%	10-20%
Real return bonds	0.0%	0.0%	0-10%
Infrastructure	6.3%	3.8%	5-15%
Hedge funds	0.0%	5.1%	0-6%
Private debt	1.3%	0.5%	0-5%
Timberland	1.8%	1.4%	0-5%
<b>EQUITIES (50%)</b>	<b>52.9%</b>	<b>50.0%</b>	<b>35-70%</b>
<b>Public</b>			
Canadian	7.8%	9.2%	0-15%
Global developed	35.3%	35.0%	20-65%
Emerging markets	3.4%	0.3%	0-10%
Frontier markets	0.0%	0.0%	0-5%
<b>Private</b>	<b>6.4%</b>	<b>5.5%</b>	<b>0-10%</b>

## Market Commentary\*

From an investor's point of view, calendar 2011 was destined to be a year where policymakers would remain in the front seat to drive markets. Conversely, many politicians would argue that they felt at the mercy of the markets. Indeed, we have seen politics and markets collide in 2011. In the U.S., the debt ceiling "Super Committee" did not find agreement on the necessary cuts to be made. Payroll tax cuts became the latest rationale for a fight under the auspices of the Congress and the "Occupy Wall Street" movement headlined nightly news. All of this, on the back of a credit rating downgrade whereby the U.S. saw its AAA- rating drop to AA+. In Europe, many politicians have fallen under the knife of elections and the anti-austerity backlash grew stronger following financial aid delivered to Greece and Ireland. Lastly, the "Arab Spring" brought civil unrest to uncharted territory as the divide between the haves and the have-nots has proven to be more deep-rooted than anticipated.

One of the most popular monetary policy initiatives is to lower yields to stimulate demand, which could, in turn, cause investors to diversify across the risk spectrum in an attempt to pursue higher returns. This has become less effective given the historic quasi-zero policy interest rates. While politicians and central bankers alike hate recessions and their consequences, pure monetary policy and quantitative easing (QE) could prove insufficient to prevent asset price deflation. Central banks might be forced down the path of even more unorthodox monetary policy. The European Central Bank (ECB) has certainly been aggressive in providing funding to Eurozone-based banks in the latter part of 2011 and the first quarter of 2012 as it succeeded in averting a banking crisis. The fundamental issue of solvency for governments though, still remains at the top of the agenda. That explains the creation of the European Stability Mechanism (ESM) in July 2011 to provide more ammunition when coupled with the European Financial Stability Facility (EFSF) launched in May 2010.

On the macro side, the global economy seemed to have been constantly sitting at an uncomfortable tipping point where strong U.S. data could have brought increased confidence while vanishing resolution prospects in the Eurozone have heightened perceived global risks. U.S. consumers have proven to be quite resilient in the last fiscal year as they dipped into their savings allowing personal spending to grow by 4.0 per cent at the same time that GDP grew by 2.2 per cent (quarterly figures annualized). Non-farm payrolls increased at a good pace throughout the fiscal year and the unemployment rate reached 8.2 per cent as the end of March 2012, down from 8.9 per cent a year earlier.

The U.S. equity markets benefited from exposure to non-U.S. sales. Furthermore, signs of an improving economy resurfaced in the first quarter of 2012, contributing to the S&P index ending the fiscal year up 11.6 per cent in C\$ terms. After reaching a high of 48 per cent in August 2011, the highest level since 2009, the VIX index, an expected equity markets volatility gauge, settled at about 15 per cent at end of fiscal year. Over the same period, Canadian stocks underperformed their U.S. counterparts returning -9.8 per cent. Concerns regarding global growth and a potential Chinese slowdown weighed negatively on the S&P TSX index given its significant commodity exposure.

As European policymakers remained mired in a crisis of their own creation, growth ground to a halt in Europe. All of the main indicators plunged in the third quarter of 2011. Even the German juggernaut was weakened momentarily. Industrial production declined in the Eurozone by 2.0 per cent on a year-over-fiscal year basis. An especially dire indicator is the youth unemployment in certain countries, Spain being the prime example, where it reached close to 50 per cent. This could easily nurture a social crisis.

Emerging markets have not been immune from the grim mood as the MSCI Emerging Markets index returned -6.2 per cent in fiscal year 2011-12 in C\$. The shock was somewhat cushioned by a relatively strong level of domestic demand across the various developing economies. In China, after oil prices reached record levels and contributed to sharply pushing up domestic inflation, expectations for lower global growth tamed inflation and provided scope for easing measures as it became evident that the property market as well as small and medium enterprises needed support.

Global stock markets, represented by the MSCI ACWI index, struggled in the second half of 2011, only to rebound in the first quarter of 2012. The index returned 2.1 per cent in C\$ during the last fiscal year. The U.S. equity markets' outperformance saved the day.



Fixed income, once again, posted positive returns. Further yield compression occurred even as bond yields remained range-bound in the jurisdictions invested in. U.S. 10-Year Treasury yields ended the fiscal year at 2.2 per cent from a high of 3.5 per cent in April 2011, while their Canadian equivalent yields reached 2.1 per cent from a similar high of 3.5 per cent earlier in 2011. In a stark contrast, 10-Year sovereign bond yields in major Eurozone countries and peripheral Europe increased meaningfully in the footsteps of the ongoing crisis. This contributed, in turn, to fuel global market uncertainty at various points in time throughout the fiscal year.

The global growth scare weighed negatively on commodities. The broad-based CRB Index endured a negative performance, returning -14.1 per cent. Looking at the sector components of the index provides a slightly different picture as crude oil (WTI) ended the fiscal year at US\$103.02/bbl up from a low of US\$75.67/bbl in October 2011. Natural gas slid by 51.5 per cent over the same period to attain a level of US\$2.12 by the end of March 2012. Copper prices declined by 11.2 per cent year-over-year and gold gained 16.5 per cent year-over-year.

On the currency side, the U.S. dollar (USD) measured against a basket of international currencies (the DXY Index) appreciated by 4.1 per cent throughout the fiscal year. It acted as a safe-haven investment as multiple episodes of risk aversion took place. The Euro (EUR) depreciated against the U.S. dollar closing the period at 1.33 USD/EUR. The Japanese Yen (JPY) remained relatively strong, trading at about 83 JPY/USD. The Canadian dollar (CAD) hovered in a tight band ending the fiscal year at 0.9987 CAD/USD.

\*Provided by AIMCo.



## Investment Performance

The Heritage Fund is managed as a long-term investment fund as set out in the act. The Fund's performance is measured on one-year performance numbers and on a five-year annualized rolling basis. The Fund has a long-term goal to achieve a return of the Canadian Consumer Price Index (CPI) + 4.5 per cent. The policy target is set to meet this goal over the long-term. In addition to this goal, AIMCo is expected to achieve the value-added target as set out in the Heritage Fund's Business Plan. This is to be achieved by selecting better-performing securities, and by making allocation decisions within the ranges given in the asset mix in the Statement of Investment Policy and Guidelines. The current value-added target that the Government expects is 1.0 per cent. The Heritage Fund earned a strong return for the fiscal year ending March 31, 2012. Total Fund return was 8.2 per cent, which beat its total return goal of 8.1 per cent. The five-year return, which reflects the 2008 financial crisis, was 2.7 per cent, falling short of the Fund's target goal of 7.3 per cent.

The policy benchmark used to measure the value added by AIMCo was 5.6 per cent. The 2.6 per cent of value added is attributable to AIMCo's tactical asset allocation decisions and their ability to select investments that out-perform the index against which they are being measured. The five-year return was 2.7 per cent. This return was 0.2 per cent below the five-year benchmark.

### Total Fund Performance

(In per cent)	2012	2011	5 Year	10 Year
Fund Rate of Return	8.2	10.4	2.7	5.7
Benchmark	5.6	9.6	2.9	5.3
Active Management	2.6	0.8	(0.2)	(0.4)
Long Term Return Target - CPI + 4.5	7.1	7.8	6.4	6.6
Active management target	1.0	1.0	0.9	0.7
Total Target Return	8.1	8.8	7.3	7.3

### Asset Class Returns versus Benchmark

(In per cent)	1 Year Return	1 Year Benchmark	5 Year Return	5 Year Benchmark
Fixed Income	9.8	9.7	5.6	6.0
Inflation sensitive and Alternative Investments	16.4	10.5	7.0	5.6
Real Estate	22.4	16.2	9.0	9.2
Infrastructure/Private Debt	6.3	2.3	7.7	6.6
Timberland	19.5	2.3	3.7	5.0
Equities	3.6	1.0	(0.9)	(0.6)
Canadian	(7.9)	(9.8)	2.0	1.7
Global	4.7	3.2	(3.4)	(3.7)
Private	14.1	2.1	2.5	8.2

## Fixed Income

At March 31, 2012, the fair value of fixed income and money market securities made up 22.3 per cent of total investments, down from 26.3 per cent the previous year. The market value at year end was \$3.7 billion, which was down from the 2011 value of \$4.1 billion. The decrease was due to the selling of some fixed income assets to increase the amount of other assets in the Fund.

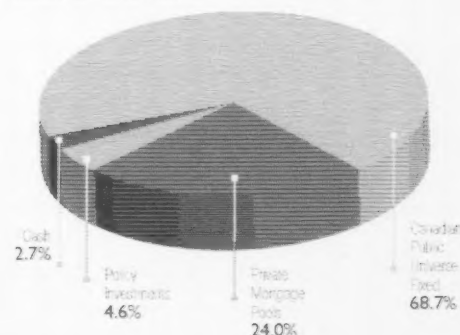
Fixed income securities are primarily held in corporate provincial and municipal bonds, Government of Canada bonds and mortgages.

Money market investments primarily include short-term, interest-bearing securities issued by banks, various levels of government and major corporations. Money market investments only represented \$99 million of the portfolio or 0.6 per cent of the total fund. The policy of the Fund is not to have too much money in cash, but a small cash balance is inevitable because of the daily flows of money.

In 2011-12, the overall fixed income and money market portfolio earned 9.8 per cent, 0.1 per cent greater than the benchmark, which was 9.7 per cent. AIMCo was able to outperform the Fund's fixed income benchmark because of the addition of mortgages to the portfolio, which returned 10.7 per cent. The mortgage portfolio makes up 24.0 per cent of the total fixed income investments.

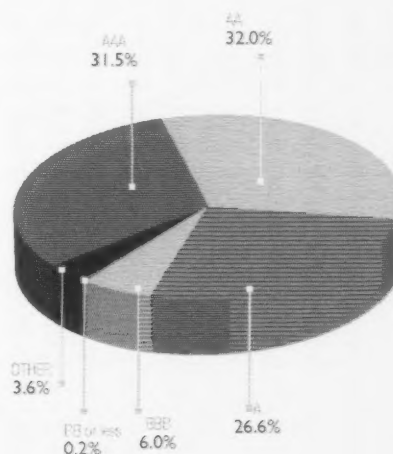
### Fixed Income

Total \$3.669 Billion



### Summary of Heritage Fund Public Fixed Income Ratings\*

as at March 31, 2012



\*\* Other - includes securities held in externally managed funds, securities for which there are no available ratings and REPOs. Does not include mortgages which are unrated.

## Inflation-sensitive and Alternative Investments

Inflation-sensitive investments provide stable returns relative to inflation. More than half of Inflation-sensitive investments are in real estate, with the balance invested in infrastructure, private debt, and timberlands. At March 31, 2012, Inflation-sensitive investments made up 24.8 per cent of total investments, up from 23.7 per cent the previous year. Total Inflation-sensitive investments amounts to \$4.08 billion, which is an increase of \$423 million. The increase is made up of some gains and new capital allocation. The new SIP&G that was put into effect April 1, 2011 calls for 30 per cent of the portfolio to be invested in these assets.

The overall combined return for Inflation-sensitive and Alternative investments in 2011-12 was 16.4 per cent, 5.9 per cent greater than the benchmark return of 10.5 per cent. This positive performance can be attributed to strong relative performance in real estate, timberlands and infrastructure. The illiquid nature of most of the Inflation-sensitive and Alternative investments creates a valuation lag, where these assets are continually playing catch-up to the more liquid public markets. The real return bond and hedge fund investment, were either divested or reclassified during the year

### Real Estate

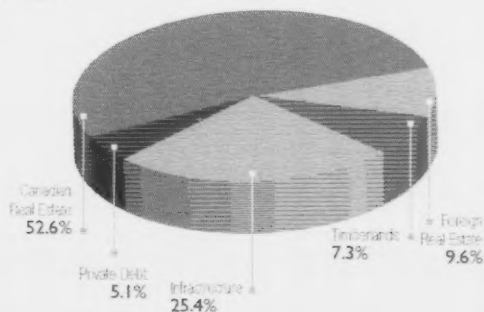
At March 31, 2012, the Fund's investment in real estate pools was \$2.5 billion, up \$550 million from \$2.0 billion at the end of the previous year. Real estate holdings are primarily Canadian with an increasing portion being devoted to foreign real estate.

Real estate has been a solid performer the past few years, after the real estate program was negatively affected by During the real estate downturn the portfolio had higher concentrations of investment in Calgary and the U.S. compared to the benchmark. The high concentration in the Calgary office market has benefited the portfolio as it has been one of the top performing markets over the past year.

The real estate holdings are predominantly Canadian, which makes up 88.4 per cent of the portfolio on a fair value basis. Of that the two biggest areas are Alberta at 31.5 per cent and Ontario with 42.5 per cent. The real estate portfolio has recently expanded its global investments and this continues to be an area where it will expand.

### Summary of Inflation-sensitive Investments

Total \$4,081 billion



### Top 10 Real Estate Holdings

as at March 31

Yorkdale Shopping Centre	Retail	Toronto
Square One	Retail	Toronto
Place Ville Marie	Office	Montreal
Scarborough Town Centre	Retail	Toronto
Bow Valley Square	Office	Calgary
Niagara Industrial Pooled Fund	Industrial	Various
8th Avenue Place	Office	Calgary
Stonegate Landing	Development	Calgary
Toronto Dominion Square	Office	Calgary
Sun Life Financial Centre	Office	Ottawa



8th Avenue Place

- 1 million square foot East tower delivered in 2011 – 100% leased with occupancy substantially underway in Q1 2012.
- 850,000 square foot West tower under construction. Leasing secured for two thirds of the building with the balance under negotiations. Completion anticipated in Q4 2014.

## Infrastructure/Private Debt

Infrastructure and private debt investments totalled \$1.25 billion at March 31, 2012, up \$585 million from the previous year. Infrastructure includes investments in projects that provide attractive returns plus inflation sensitivity with a long investment horizon. Infrastructure projects include transportation/logistics (e.g., toll roads, airports, ports and rail); power/energy (e.g., contracted power generation, power transmission and pipelines); and utilities (e.g., water, waste water and natural gas networks).

Infrastructure and private debt returned 6.3 per cent compared to its benchmark return of 2.3 per cent. The infrastructure portfolio that AIMCo manages is also going through a transition, with AIMCo looking for more direct investments. The large year-over-year increase in infrastructure investments was partly due to the large direct investment in the Chilean toll road Autopista Central.

## Timberlands

Investments in Canadian and foreign timberland totalled \$297 million at March 31, 2012, up \$81 million from the previous year. The Canadian investment accounts for one third of the total timberland investment and primarily includes an ownership interest in timber and related land located in British Columbia. The remaining two-thirds of the timberland investments are outside Canada, primarily in Australia.

The Timberland portfolio returned 19.5 per cent versus its benchmark return of 2.3 per cent.

## Top 10 Infrastructure Holdings

as at March 31

Autopista Central	Transportation	Chile
Saesa Group	Integrated Utilities	Chile
Puget Sound Energy	Integrated Utilities	US
Frequency Infrastructure Group	Communication	AUS/UK
First Wind	Power Generation	US
Thames Water	Water	UK
Compania Logistica de Hidrocarburos	Pipelines & Midstream	Spain
Kinder Morgan Inc.	Pipelines & Midstream	US
Copenhagen Airport	Transportation	Denmark
Brussels Airport	Transportation	Belgium



Autopista Central S.A.

- 61.5 km of high speed road with free flow tolling technology
- Running north-south through the heart of Santiago, Chile, having a greater area population of 6.8 million people
- Concession awarded in 2000, extending until 2031
- Comprises 40% of the traffic volume of the entire Santiago urban toll road network
- Solid expected traffic growth alongside Chilean GDP
- Has led to a meaningful reduction in accidents and deaths in Santiago since operation due to improvements in traffic congestion

## Equities

The Heritage Fund's equity portfolio returned 3.6 per cent. After a very negative start in the first two quarters, the equity markets clawed their way back to earn a positive return for the fiscal year. Of the 3.6 per cent return on equities, 2.6 per cent was attributed to AIMCo's ability to add value, as the benchmark return for equities was 1.0 per cent. The equity portfolio at March 31, 2012, made up 52.9 per cent of the total portfolio, with a total of \$8.7 billion invested. This is up from 50.0 per cent, or \$7.7 billion, at the end of the previous fiscal year.

### Canadian Equities

Fears of an economic slowdown linked to the sovereign debt crisis in Europe caused the resource dominated S&P/TSX Composite to drop 9.8 per cent for the year ended March 31, 2012. The returns of the Energy and Material sub-sectors of the S&P/TSX showed weakness, returning -19.8 per cent and -20.6 per cent respectively. Another significant contributor to the Canadian Equity markets poor performance was Research in Motion, which was down 73.3 per cent for the year. Canadian equity investments in the Fund were \$1.3 billion at the end of 2011-12 fiscal year. This was a decrease from the \$1.4 billion that was invested at the end of the previous year. This decrease is consistent with the long-term strategy for the Fund to have a more global focus. The Canadian equity portfolio, which posted a -7.9 per cent return outperformed its benchmark by 1.9 per cent.

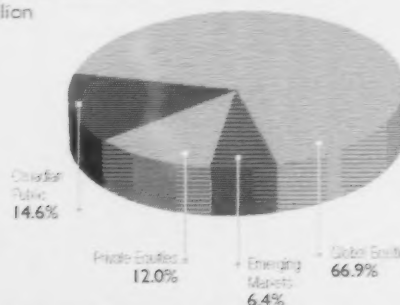
### Global Equities

Global equities had a 4.7 per cent return versus the benchmark return of 3.2 per cent. Currency fluctuation did not have a significant impact on investment returns this year as it has in previous years. The Canadian dollar depreciated slightly which actually helped the returns of our foreign denominated assets.

At March 31, 2012, global equities totalled \$6.4 billion, up \$0.9 billion from \$5.5 billion the previous year. Approximately half of the global equity portfolio is invested in the U.S. and half in Europe, Australasia, and the Far East. A portion of global equity is invested in structured equity products using index swaps and futures contracts, which replicate exposure to global equity markets. Emerging market public equities make up 8.8 per cent of the global equity portfolio and include investments in economies that are in the early stages of development, have sufficient market size and liquidity, and have an investment climate that is receptive to foreign investors. China, Brazil, Korea, Taiwan and Russia make up about 66 per cent of the emerging markets.

### Summary of Equity Investments by Pool

Total \$8.705 billion



### Top 10 Canadian Equity Holdings as at March 31

Holdings	% of Total Canadian Equity
Royal Bank of Canada	5.2%
Toronto-Dominion Bank/The	4.7%
Suncor Energy Inc	4.2%
Bank of Nova Scotia	3.6%
CIBC	3.4%
Barrick Gold Corp	3.4%
Enbridge Inc	2.9%
Canadian Natural Resources Ltd	2.7%
Canadian National Railway Co	2.7%
Teck Resources Ltd	2.2%
<b>Total</b>	<b>35.1%</b>



Precision Drilling

- Canada's largest oilfield services company and a leading North American contract drilling company
- Operates in virtually all oil & gas basins in North America
- Revenues of \$1.43 billion in 2010

### Top 10 Canadian Equity Holdings as at March 31

Holdings	% of Total Global Equity
Viterra Inc	4.7%
Precision Drilling Corp	2.6%
Apple Inc	2.2%
Exxon Mobil Corp	1.6%
BRF - Brasil Foods SA	1.1%
Microsoft Corp	1.0%
International Business Machines Corp	0.9%
Royal Dutch Shell PLC	0.9%
Johnson & Johnson	0.8%
Chevron Corp	0.8%
<b>Total</b>	<b>16.5%</b>



Viterra Inc

- Global food ingredients company
- Sourced and marketed grain delivered to customers in more than 50 countries
- Revenue of \$8.3 billion in 2010



## Private Equities

### Top 10 Private Equity Holdings as at March 31

Company	Sector
Bloom	Energy
Tomkins Limited	Industrials
Bonanza Creek	Energy
Kior	Energy
Ladder	Financials
Klemke Mining Corporation	Industrials
Chinook	Energy
Petro Tiger	Energy
Mosaid	Telecommunication Services
Q'Max Solutions Inc.	Energy

Canadian and foreign private equities totalled \$1.05 billion at March 31, 2012, up \$200 million from \$845 million the previous year. Private equity investments primarily include investments such as: expansion capital, acquisition financings, management buyouts, family succession, turnaround financings, project financings and leverage reductions. AIMCo is in the process of implementing a new strategy for the private equity portfolio. The new strategy is focused on divesting some of the fund of funds type investments, freeing up capital for more opportunistic direct transactions.

The private equity portfolio had a 14.1 per cent return, which significantly beat its benchmark of 2.1 per cent.

## Currency Exposure

The Heritage Fund invests in a globally diversified portfolio, but remains predominantly a Canadian dollar fund. The current policy of the Fund is not to hedge away the currency risk. The majority of the Fund's assets are denominated in Canadian Dollars, which amounts to 57.8 per cent of the Fund at March 31, 2012. This is down from the previous year, when the Fund had 61.7 per cent invested in Canadian dollar denominated assets. The decline is the result of the Heritage Fund moving to be a more globally diversified portfolio. The rest of the assets are allocated globally in thirty-seven other currencies, the main ones being the US dollar, Euro, Japanese yen and British pound.

Currency Exposure		as at March 31	
		2012	2011
CAD	Canadian Dollar	58.2%	61.7%
USD	US Dollar	22.4%	19.9%
GBP	British Pound	3.2%	3.2%
EUR	Euro	5.0%	5.4%
JPY	Japanese Yen	3.1%	3.1%
AUD	Australian Dollar	1.8%	2.2%
CHF	Swiss Franc	1.1%	1.0%
Other		5.2%	3.5%
<b>Total</b>		<b>100.0%</b>	

# Historical Summary

May 19, 1976 to March 31, 2012

(See Note 5 to the Financial Statements)

(In millions)

Fiscal Year	Net Income (Loss) (a)	TRANSFERS TO THE FUND			TRANSFERS (FROM) THE FUND			Fund Equity, at cost
		Resource	Advanced Education		Section 8 (2)	Capital	Fund Equity, at cost	
		Revenue Allocation	New Deposits	Endowment (b)	Income Transfers (c)	Project Expenditures		
1976-77	\$88	\$2,120	-	-	-	(\$36)	\$2,172	
1977-78	194	931	-	-	-	(87)	3,210	
1978-79	294	1,059	-	-	-	(132)	4,431	
1979-80	343	1,332	-	-	-	(478)	5,628	
1980-81	724	1,445	-	-	-	(227)	7,570	
1981-82	1,007	1,434	-	-	-	(349)	9,662	
1982-83	1,482	1,370	-	-	(867)	(296)	11,351	
1983-84	1,467	720	-	-	(1,469)	(330)	11,739	
1984-85	1,575	736	-	-	(1,575)	(228)	12,247	
1985-86	1,667	685	-	-	(1,667)	(240)	12,692	
1986-87	1,445	217	-	-	(1,445)	(227)	12,682	
1987-88	1,353	-	-	-	(1,353)	(129)	12,553	
1988-89	1,252	-	-	-	(1,252)	(155)	12,398	
1989-90	1,244	-	-	-	(1,244)	(134)	12,264	
1990-91	1,337	-	-	-	(1,337)	(150)	12,114	
1991-92	1,382	-	-	-	(1,382)	(84)	12,030	
1992-93	785	-	-	-	(785)	(84)	11,946	
1993-94	1,103	-	-	-	(1,103)	(71)	11,875	
1994-95	914	-	-	-	(914)	(49)	11,826	
1995-96 (e)	1,046	-	-	-	(1,046)	-	11,826	
1996-97	932	-	-	-	(756)	(d)	-	12,002
1997-98	947	-	-	-	(922)	(d)	-	12,027
1998-99	932	-	-	-	(932)	-	-	12,027
1999-00	1,169	-	-	-	(939)	(d)	-	12,257
2000-01	706	-	-	-	(706)	-	-	12,257
2001-02	206	-	-	-	(206)	-	-	12,257
2002-03	(894)	-	-	-	-	-	-	11,363
2003-04	1,133	-	-	-	(1,133)	-	-	11,363
2004-05	1,092	-	-	-	(1,092)	-	-	11,363
2005-06	1,397	-	1,000	750	(1,015)	(d)	-	13,495
2006-07	1,648	-	1,000	250	(1,365)	(d)	-	15,028
2007-08	824	-	918	-	(358)	(d)	-	16,412
2008-09	(2,574)	-	-	-	-	-	-	13,838
2009-10	2,006	-	-	-	(2,006)	-	-	13,838
2010-11	1,080	-	-	-	(720)	(d)	-	14,198
2011-12	798	-	-	-	(344)	(d)	-	14,652
TOTAL	\$32,104	\$12,049	\$2,918	\$1,000	(\$29,933)	(\$3,486)		\$14,652

(a) The net income of the Fund and its assets and liabilities, net of consolidation adjustments, is included in the consolidated financial statements of the Ministry of Finance and the Government of Alberta.

(b) The *Access to the Future Act* allows for a maximum of \$3 billion to be transferred into the Fund to support the advanced education endowment.

(c) In accordance with section 8(2) of the *Alberta Heritage Savings Trust Fund Act*, the net income of the Fund, less any amount retained in the Fund to maintain its value from inflation, shall be transferred to the GRF, annually in a manner determined by the Minister of Finance.

(d) The difference between net income and the amount transferred to GRF represents the amount retained in the Fund for inflation-proofing. At March 31, 2012, the accumulated amount retained in the Fund for inflation-proofing was \$2,376 million (2011: \$1,922 million).

(e) March 31, 1996 marked the end of the old structure of the Heritage Fund. In 1996-97, the Fund commenced a structuring process under a new framework. The new framework provided for a transition into more market based investments, inflation-proofing the Fund and a long-term investment horizon providing for the greatest financial returns on investments.



# Audited Financial Statements

March 31, 2012

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Statement of Operations and Net Assets	23
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# Independent Auditor's Report

To the President of Treasury Board and Minister of Finance



## Report on the Financial Statements

I have audited the accompanying financial statements of the Alberta Heritage Savings Trust Fund, which comprise the statement of financial position as at March 31, 2012 and the statements of operations and net financial assets, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Alberta Heritage Savings Trust Fund as at March 31, 2012 and the results of its operations and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

[Original signed by Merwan N. Saher, FCA ]

Auditor General

June 8, 2012

Edmonton, Alberta

## Statement of Financial Position

As at March 31, 2012  
(in millions)

	2012	2011
<b>Financial assets</b>		
Portfolio investments (Note 3)	\$ 15,015	\$ 14,455
Receivable from sale of investments and accrued income	13	19
	<u>\$ 15,028</u>	<u>\$ 14,474</u>
<b>Liabilities</b>		
Due to the General Revenue Fund	\$ 344	\$ 276
Payable from purchase of investments and amounts payable	32	-
	<u>376</u>	<u>276</u>
<b>Net financial assets (Note 5)</b>	<u>14,652</u>	<u>14,198</u>
	<u>\$ 15,028</u>	<u>\$ 14,474</u>

## Statement of Operations and Net Financial Assets

Year Ended March 31, 2012  
(in millions)

	2012	2011
	Budget	Actual
Investment income (Note 6)	\$ 1,050	\$ 897
Investment expenses (Note 7)	(80)	(99)
<b>Net income</b>	<u>970</u>	<u>1,080</u>
Transfers to the General Revenue Fund (Note 5b)	(631)	(720)
<b>Net income retained in the Fund (Note 5b)</b>	<u>\$ 339</u>	<u>360</u>
<b>Net financial assets at beginning of year</b>	14,198	13,838
<b>Net financial assets at end of year</b>	<u>\$ 14,652</u>	<u>\$ 14,198</u>

*The accompanying notes are part of these financial statements.*

# Statement of Cash Flows

Year Ended March 31, 2012  
(in millions)

	2012	2011
<b>Operating transactions</b>		
Net income	\$ 798	\$ 1,080
Non-cash items included in net income	(219)	(136)
	579	944
Decrease in accounts receivable	6	6
Increase (decrease) in accounts payable	32	(1)
Cash provided by operating transactions	617	949
<b>Investing transactions</b>		
Proceeds from disposals, repayments and redemptions of investments	4,243	2,656
Purchase of investments	(4,590)	(3,133)
Cash used by investing transactions	(347)	(477)
<b>Transfers</b>		
Transfers to the General Revenue Fund	(344)	(720)
Increase in amounts due to the General Revenue Fund	68	270
Cash used in transfers	(276)	(450)
<b>(Decrease) increase in cash</b>	(6)	22
Cash at beginning of year	105	83
Cash at end of year	\$ 99	\$ 105
<b>Consisting of Deposits in the Consolidated Cash Investment Trust Fund (Note 3a)</b>	\$ 99	\$ 105

*The accompanying notes are part of these financial statements.*

# Notes to the Financial Statements

March 31, 2012  
(in millions)

## **NOTE 1** AUTHORITY AND MISSION

The Alberta Heritage Savings Trust Fund (the Fund) operates under the authority of the *Alberta Heritage Savings Trust Fund Act*, Chapter A-23, Revised Statutes of Alberta 2000 (the Act), as amended.

The preamble to the Act describes the mission of the Fund as follows:

*"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."*

## **NOTE 2** SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

These financial statements are prepared in accordance with Canadian public sector accounting standards.

The accounting policies of significance to the Fund are as follows:

### **a) FUTURE CHANGE IN ACCOUNTING POLICY**

Government must adopt the new standard PS 3450 - Financial Instruments by fiscal year 2015-16 but has the option to adopt earlier. The impact of this on government financial statements is currently being analyzed. All government controlled organizations will adopt this standard in fiscal year 2012-13.

When the Fund adopts this standard it will be applied on a prospective basis. As a result, comparative amounts will not be restated. The primary changes to the Fund's financial statements when it is adopted will be as follows:

- i) The carrying amount of the financial instruments included in portfolio investments will be recorded based on their fair value. Currently, portfolio investments are recorded at cost.
- ii) Unrealized gains and losses will be recorded in the new statement of re-measurement gains and losses. Currently unrealized gains and losses are not recorded in the financial statements.
- iii) Disclosure of the hierarchy of inputs used in the determination of fair value for investments will be reported according to the following levels:
  - (a) Level one: fair value is based on quoted prices in an active market.
  - (b) Level two: fair value is based on model-based valuation methods for which all significant assumptions are observable in the market or quoted prices for similar but identical assets.
  - (c) Level three: fair value is based on valuation methods where inputs that are based on non-observable market data have a significant impact on the valuation.

### **b) PORTFOLIO INVESTMENTS**

The Fund invests in units of pooled investment funds established and administered by Alberta Investment Management Corporation (AIMCo). Pooled investment funds have a

market-based unit value that is used to allocate income to pool participants and to value purchases and sales of pool units. Pooled investment funds include financial instruments (including derivatives), investment receivables and liabilities, and cash.

Investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments. Investments in loans are recorded at cost less any allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a specific provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

Investments are recorded as of the trade date.

The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost. Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short-term market trends and is temporary in nature.

#### c) INVESTMENT INCOME AND EXPENSES

Investment income and expenses, as reported in Notes 6 and 7, are recorded on the accrual basis. Investment income is accrued when there is reasonable assurance as to its measurement and collectability. When a loan becomes impaired, recognition of interest income in accordance with the terms of the original loan agreement ceases. Any subsequent payments received on an impaired loan are applied to reduce the loan's book value. For certain investments such as private equities, private infrastructure, private real estate, hedge funds and timberland investments, the actual income and expenses may not be known at the time the financial statements are prepared. In these cases, estimates may be used, which may vary from actual income and expenses.

Net recognized gains and losses arising as a result of disposals of investments, including those arising from derivative transactions, are included in the determination of investment income.

Changes in fair value of derivative contracts are included in investment income except for certain derivative contracts designated as hedges of market risks for purposes of hedge accounting. Hedge accounting recognizes gains and losses from derivatives in the statement of income in the same year as the gains and losses of the security being hedged.

Where a hedge relationship is designated, the hedge is documented at inception. The documentation identifies the specific asset being hedged, the risk that is being hedged, type of derivative used and the matching of critical terms of both the hedged security and the hedging derivative for purposes of measuring effectiveness. The derivative must be highly effective in accomplishing the objective of offsetting either changes in the fair value or cash flows attributable to the risk being hedged both at inception and over the life of the hedge. When the derivative no longer qualifies as an effective hedge, the hedge accounting is discontinued prospectively. If hedge accounting is discontinued, gains and losses resulting from the changes in fair value of the derivative contract are recognized in income immediately.



**d) FOREIGN CURRENCY**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange. At year end, the fair value of investments in other assets and liabilities denominated in a foreign currency are translated at the year end exchange rates. Exchange differences on transactions are included in the determination of investment income.

**e) VALUATION OF INVESTMENTS**

Portfolio investments are recorded in the financial statements at cost. The fair value of investments is provided for information purposes and is disclosed in Note 3. The Fund's cut-off policy for valuation of investments, investment income and investment performance is based on valuations provided by AIMCo at the close of the 6th business day following the year end. Differences in valuation estimates provided to Alberta Finance after the year end cut-off date are reviewed by management. Differences considered immaterial by management are included in investment income in the following year.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

The methods used by AIMCo to determine fair value of investments held either by the Fund or by pooled investment funds is explained in the following paragraphs:

- i) Public interest-bearing securities and equities are valued at the year end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.
- ii) Mortgages and private interest-bearing debt are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.
- iii) The fair value of private equities and infrastructure investments is estimated by managers or general partners of private equity and infrastructure funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and earnings multiple analysis.
- iv) The estimated fair value of real estate investments is reported at the most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including replacement cost, direct comparison, direct capitalization of earnings and the discounted cash flows.
- v) The fair value of hedge fund investments is estimated by external managers.
- vi) The fair value of loans is estimated by management based on the present value of discounted cash flows.
- vii) The fair value of timberland investments is appraised annually by independent third party evaluators.
- viii) The fair value of deposits, receivables, accrued interest and payables is estimated to approximate their book values.



**f) VALUATION OF DERIVATIVE CONTRACTS**

Derivative contracts include equity and bond index swaps, interest rate swaps, cross-currency interest rate swaps, credit default swaps, forward foreign exchange contracts, equity index futures contracts, warrants and swap option contracts. As disclosed in Note 3, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

- i) Equity and bond index swaps are valued based on changes in the appropriate market-based index net of accrued floating rate interest.
- ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates.
- iii) Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities.
- iv) Forward foreign exchange contracts and futures contracts are valued based on quoted market prices.
- v) Options to enter into interest rate swap contracts are valued based on discounted cash flows using current market yields and volatility parameters which measure changes in the underlying swap.
- vi) Warrants and rights are valued at the year end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

**g) MEASUREMENT UNCERTAINTY**

Measurement uncertainty exists in the fair values reported for certain investments such as private equities, private infrastructure, private debt and loans, private real estate, hedge funds, timberland investments, and other investments where no readily available market exists. The fair values of these investments are based on estimates. Estimated fair values may not reflect amounts that could be recognized upon immediate sale, or amounts that ultimately may be recognized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments.

Changes in estimated fair value of investments are reported in the period in which new information is received.

**NOTE 3 PORTFOLIO INVESTMENTS (in millions)**

	2012			2011		
	Cost	Fair Value	%	Cost	Fair Value	%
<b>Interest-bearing securities</b>						
Deposits and short-term securities <sup>(a)</sup>	\$ 99	\$ 99	0.6	\$ 119	\$ 119	0.7
Bonds and mortgages <sup>(b)</sup>	3,474	3,570	21.7	3,948	3,954	25.6
	3,573	3,669	22.3	4,067	4,073	26.3
<b>Equities</b>						
Canadian <sup>(c)</sup>	1,209	1,272	7.8	1,214	1,414	9.2
Global developed <sup>(d)</sup>	5,505	5,825	35.3	5,141	5,412	35.0
Emerging markets <sup>(e)</sup>	523	561	3.4	46	45	0.3
Private <sup>(f)</sup>	901	1,047	6.4	797	845	5.5
	8,138	8,705	52.9	7,198	7,716	50.0
<b>Inflation sensitive and alternative investments</b>						
Real estate <sup>(g)</sup>	1,829	2,537	15.4	1,544	1,987	12.9
Inflation sensitive real return bonds	-	-	-	4	5	-
Infrastructure <sup>(h)</sup>	1,030	1,038	6.3	641	587	3.8
Absolute return strategy hedge funds <sup>(i)</sup>	-	-	-	720	788	5.1
Timberland <sup>(j)</sup>	248	297	1.8	205	216	1.4
Private debt and loan <sup>(k)</sup>	197	209	1.3	76	75	0.5
	3,304	4,081	24.8	3,190	3,658	23.7
<b>Total Investments <sup>(l)</sup></b>	<b>\$ 15,015</b>	<b>\$ 16,455</b>	<b>100.0</b>	<b>\$ 14,455</b>	<b>\$ 15,447</b>	<b>100.0</b>

The Fund's investments are managed at the asset class level for purposes of evaluating the Fund's risk exposure and investment performance against approved benchmarks based on fair value. AIMCo invests the Fund's assets in accordance with the *Statement of Investment Policies and Goals* (SIP&G) approved by the Minister of Finance. The majority of the Fund's investments, in each asset class, are held in pooled investment funds established and administered by AIMCo. The fair value of pool units (See Note 2e) is based on the Fund's share of the net asset value of the pooled investment funds. Pooled investment funds have a market based unit value that is used to allocate income to participants of the pool and to value purchases and sales of pool units. AIMCo is delegated authority to independently purchase and sell securities in the pools and Fund, and units of the pools, within the ranges approved for each asset class (see Note 4).

- a) Deposits and short-term securities includes deposits in the Consolidated Cash Investment Trust Fund (CCITF), being cash as reported in the Statement of Cash Flows, of \$99 (2011: \$105) and short-term securities of nil (2011: \$14). Terms to maturity and market yield at March 31, 2012 are reported in Note 4c.
- b) Bond and mortgage pooled funds include universe bonds totalling \$2,459 (2011: \$2,883), private mortgages totalling \$847 (2011: \$797), policy investments of \$168 (2011: \$148) and other securities of nil (2011: \$120). The portfolio includes government direct and guaranteed bonds and mortgage-backed securities, corporate bonds and asset-backed securities, private debt issues, private mortgages, repurchase agreements, debt-related derivatives and loans. Terms to maturity and market yield at March 31, 2012 are reported in Note 4c.

Included in bonds and mortgages are two policy investments held in the Fund prior to its restructuring in 1996-97. These policy investments include:

- 11% participating first mortgage bonds, due July 31, 2015, principal due \$165, current carrying value \$165, accrued interest \$12.
  - Loan, due July 2046, principal due \$53, current carrying value \$3.
- c) Canadian public equity pooled funds include directly held investments in Canadian public companies and indirect exposure to Canadian public equity markets through structured equity products using index swaps and futures contracts linked to the Standard and Poor's Toronto Stock Exchange (S&P/TSX) Composite Index and S&P/TSX 60 Index.
- d) The global developed market is used to describe countries whose economies and capital markets are well established and mature. The Fund's global developed public equity pooled funds invest in directly held investments in public companies in the U.S., Europe, Australasia and the Far East (EAFE), emerging markets and Canada. The Fund's indirect exposure to global developed markets and emerging markets is also attained by investing in structured equity products using index swaps and futures contracts linked to the Morgan Stanley Capital International (MSCI) World Total Return Index, MSCI EAFE Index, S&P 500 Index and Emerging Markets Free Net Index. A component of the Fund's global portfolio includes investments in North American concentrated equities which include larger holdings in mid-size Canadian and American companies ranging from 5% to 20% of outstanding common shares. The portfolio also included value-added hedge funds which are externally managed.
- e) Emerging market pooled funds consist of publicly traded equities in countries in the process of rapid growth and industrialization such as Brazil, Russia, India and China. The portfolio is actively managed by external managers with expertise in emerging markets.
- f) Private equity pooled funds hold Canadian and foreign private investments, including merchant banking investments. Merchant banking transactions include expansion capital, acquisition financing, management buyouts, family succession, turnaround financings, project financings and leverage reductions.
- g) The Fund's real estate portfolio is comprised of investments in units of AIMCo's Canadian Private Real Estate Pools (80%) and Foreign Private Real Estate Pool (20%). In the Canadian Private Real Estate Pools, real estate is held primarily through intermediary companies which issue common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by provinces and cities in Canada, by property type and tenancy. Real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities.
- h) Infrastructure pooled funds hold infrastructure partnerships that are structured to provide high returns plus inflation sensitivity with a long investment horizon. Investments may include transportation and logistic investments (e.g. toll roads, airports, ports and rail), power or energy investments (e.g. contracted power generation, power transmission pipelines) and utilities (e.g. water, waste water, natural gas networks).
- i) Effective April 1, 2011 hedge fund assets are classified under equities in accordance with the Fund's SIP&G and on June 30, 2011 hedge fund assets were transferred to the global developed portfolio. The absolute return strategies (hedge funds) use external

managers who employ various investment strategies which are expected to produce absolute positive investment returns with lower volatility. Investments are made through multi-hedge fund-of-funds and direct investments to increase strategy diversification.

- j) Canadian and foreign timberland investments are inflation sensitive and long-duration. The Canadian timberland investment includes an interest in timber and related land located in the Province of British Columbia. The foreign investment primarily includes forestry and agricultural land in Australia.
- k) The private debt and loan pooled fund holds investments that are in Canada, the United States and Europe. The debt will generally be unrated and if rated would be non-investment grade, i.e. BB and lower. These investments may include senior secured loans, leveraged loans, mezzanine debt and convertible debt.
- l) Included in the fair value of the Fund's investments in various pooled funds, summarized in Note 3 by asset class, is the fair value of derivative contracts. A derivative is a financial contract with the following three characteristics (1) its value changes in response to the changes in a specified interest rate, equity or bond index price, foreign exchange rate or credit rating; (2) it requires no initial net investment or the initial investment is smaller than required for exposure to a similar investment market and (3) it is settled in the future. AIMCo uses various types of derivative contracts in the pooled investment funds to gain access to equity markets and enhance returns, manage exposure to interest rate risk, currency risk and credit risk and for asset mix purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows with a counter-party. At March 31, 2012, the net fair value of derivative related investments, including deposits in futures contracts margin accounts and collateral accounts, totalled \$123 million or 0.7% of total investments (2011: \$197 million or 1.3% of total investments).

Net derivative related receivables of \$105 are comprised of net receivables from counterparties of \$175 and net payables to counterparties of \$70. The current credit exposure is represented by the amount of net receivables from counterparties. Cash flows associated with receivables and payables on derivative contracts is generally settled every three months.

At March 31, 2012 the value of equity replication derivatives includes amounts related to counterparties that are public service pension plans and Government of Alberta endowment funds managed by AIMCo. The net fair value of these contracts totalled \$6 (2011: \$(1)).

The following is a summary of the Fund's proportionate share of the notional amount and fair value for each class of derivative financial instrument included in the fair value of the pooled fund investments at March 31, 2012 (in millions):

Purpose	Maturity			2012		2011	
	Under 1 year	1 to 3 Years	Over 3 Years	Notional Amount	Fair Value	Notional Amount	Fair Value
				(a)	(b)	(a)	(b)
Interest rate derivatives <sup>(c)</sup>	59%	22%	19%	\$ 1,802	\$ 9	\$ 1,947	\$ 10
Equity replication derivatives <sup>(d)</sup>	91%	9%	-	8,603	127	8,024	30
Foreign currency derivatives <sup>(e)</sup>	99%	1%	-	4,416	(12)	6,889	38
Credit risk derivatives <sup>(f)</sup>	34%	18%	48%	1,544	(19)	1,811	(17)
Derivative related receivables, net					105		61
Deposits in futures contracts margin accounts					13		136
Deposits as collateral for derivative contracts					5		-
Net derivative related investments					<u>\$ 123</u>		<u>\$ 197</u>

(a) The notional amounts upon which payments are based are not indicative of the credit risk associated with derivative contracts. Current credit exposure is represented by the current replacement cost of all outstanding contracts in a favourable position (positive fair value).

(b) The method for determining the fair value of derivative contracts is described in Note 2(f).

(c) Interest rate derivatives allow the Fund to exchange interest rate cash flows (fixed, floating and bond index) based on a notional amount. Interest rate derivatives primarily include interest rate swaps and cross currency interest rate swaps, bond index swaps and futures contracts and options.

(d) Equity replication derivatives provide for the Fund to receive or pay cash based on the performance of a specified market-based equity index, security or basket of equity securities applied to a notional amount. Equity derivatives primarily include equity index swaps, futures contracts and rights, warrants and options.

(e) Foreign currency derivatives include contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(f) Credit risk derivatives include credit default swaps allowing the Fund to buy and sell protection on credit risk inherent in a bond. A premium is paid or received, based on a notional amount in exchange for a contingent payment should a defined credit event occur with respect to the underlying security.

#### NOTE 4 INVESTMENT RISK MANAGEMENT

The Fund is exposed to financial risks associated with the underlying securities held in the pooled investment funds created and managed by AIMCo. These financial risks include credit risk, market risk and liquidity risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Market risk is comprised of currency risk, interest rate risk and price risk. Liquidity risk is the risk the Fund will not be able to meet its obligations as they fall due.

The investment policies and procedures of the Fund are clearly outlined in the *Statement of Investment Policies and Goals* (SIP&G) approved by the Minister of Finance. The purpose of the SIP&G is to ensure the Fund is invested and managed in a prudent manner in accordance with current, accepted governance practices incorporating an appropriate level of risk. The Ministry of Finance manages the Fund's return-risk trade-off through asset class diversification, target ranges on each asset class, diversification within each asset class, quality constraints on fixed income instruments and restrictions on amounts exposed to countries designated as emerging markets. Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign



currency (see Note 3l). In order to earn the best possible return at an acceptable level of risk, the Minister approved the following long-term asset mix policy ranges:

Interest-bearing securities .....	15-45 %
Equities .....	35-70 %
Inflation sensitive and alternative investments .....	15-40 %

**a) CREDIT RISK**

Counterparty credit risk is the risk of loss arising from the failure of a counterparty to fully honour its financial obligations with the Fund. The credit quality of financial assets is generally assessed by reference to external credit ratings. Credit risk can also lead to losses when issuers and debtors are downgraded by credit rating agencies usually leading to a fall in the fair value of the counterparty's obligations. Credit risk exposure for financial instruments is measured by the positive fair value of the contractual obligations with counterparties. The fair value of all investments reported in Note 3 is directly or indirectly impacted by credit risk to some degree. The majority of the Fund's investments in debt securities are with counterparties considered to be investment grade.

The Fund is exposed to credit risk associated with the underlying debt securities held in pooled investment funds managed by AIMCo. The following table summarizes the Fund's investment in debt securities by counterparty credit rating at March 31, 2012:

<b>Credit rating</b>	<b>Fair Value</b>
Investment Grade (AAA to BBB-)	76%
Speculative Grade (BB+ or lower)	-
Unrated	24%
	<u>100%</u>

The Fund's maximum credit risk in respect of derivative financial instruments is the fair value of all derivative-related receivables from counterparties (see Note 3l). The Fund can only transact with counterparties to derivative contracts with a credit rating of A+ or higher by at least two recognized ratings agencies. Provisions are in place to either transfer or terminate existing contracts when the counterparty has their credit rating downgraded. The exposure to credit risk on derivatives is reduced by entering into master netting agreements and collateral agreements with counterparties. To the extent that any unfavourable contracts with the counterparty are not settled, they reduce the Fund's net exposure in respect of favourable contracts with the same counterparty.

To generate additional income, the Fund participates in a securities-lending program. Under this program, the custodian may lend investments held in pooled funds to eligible third parties for short periods. Securities borrowers are required to provide the collateral to assure the performance of redelivery obligations. Collateral may take the form of cash, other investments or a bank-issued letter of credit. All collateralization, by the borrower, must be in excess of 100% of investments loaned.

**b) FOREIGN CURRENCY RISK**

The Fund is exposed to foreign currency risk associated with the underlying securities held in pooled investment funds that are denominated in currencies other than the Canadian dollar. Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The fair value of investments denominated in foreign currencies is translated into Canadian dollars using the reporting date exchange rate. As a result, fluctuations in the relative value of the Canadian

dollar against these foreign currencies can result in a positive or negative effect on the fair value of investments. Approximately 42% of the Fund's investments, or \$6,889 million, are denominated in currencies other than the Canadian dollar, with the largest foreign currency exposure being to the US dollar (22%) and the euro (5%).

If the value of the Canadian dollar increased by 10% against all other currencies, and all other variables are held constant, the potential loss in fair value to the Fund would be approximately 4.2% of total investments (2011: 4.6%).

The following table summarizes the Fund's exposure to foreign currency investments held in pooled investment funds at March 31, 2012:

Currency	(\$ millions)	
	2012	
	Fair Value	Sensitivity
U.S. dollar	\$ 3,679	\$ 368
Euro	828	83
Japanese yen	503	50
British pound sterling	532	53
Australian dollar	289	29
Swiss franc	183	18
Other foreign currency	875	87
Total foreign currency investments	\$ 6,889	\$ 688

#### c) INTEREST RATE RISK

The Fund is exposed to interest rate risk associated with the underlying interest-bearing securities held in the pooled investment funds managed by AIMCo. Interest rate risk relates to the possibility that the fair value of investments will change due to future fluctuations in market interest rates. In general, investment returns from bonds and mortgages are sensitive to changes in the level of interest rates, with longer term interest bearing securities being more sensitive to interest rate changes than shorter-term bonds. If interest rates increased by 1%, and all other variables are held constant, the potential loss in fair value to the Fund would be approximately 1.2% of total investments (2011: 1.3%).

The following table summarizes the terms to maturity of interest-bearing securities held in pooled investment funds at March 31, 2012:

Asset Class	< 1 year	1 - 5 years	Over 5 years	Average Effective Market
Deposits and short term securities	91%	9%	-	1.3%
Bonds and mortgages	4%	47%	49%	4.4%

#### d) PRICE RISK

Price risk relates to the possibility that equity investments will change in fair value due to future fluctuations in market prices caused by factors specific to an individual equity investment or other factors affecting all equities traded in the market. The Fund is exposed to price risk associated with the underlying equity investments held in pooled investment funds managed by AIMCo. The Fund's investments are recorded at cost. Changes in fair value of investments are recognized upon sale of the investment. If equity market indices (S&P/TSX, S&P500, S&P1500 and MSCI ACWI and their sectors) declined by 10%, and all other variables are held constant, the potential loss in fair value to the Fund would be approximately 6.0% of total investments (2011: 4.3%).



e) **LIQUIDITY RISK**

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with its financial liabilities. Liquidity requirements of the Fund are met through income generated from investments, and by investing in publicly traded liquid assets traded in an active market that are easily sold and converted to cash. These sources of cash are used to pay operating expenses, purchase new investments, and settle derivative transactions with counterparties and margin calls on futures contracts. The Fund's main liabilities include transfers payable to the General Revenue Fund and payables for investment purchases.

**NOTE 5** **NET FINANCIAL ASSETS** (in millions)

Net financial assets represent the difference between the carrying value of financial assets held by the Fund and its liabilities. The following table shows accumulated net income and transfers to (from) the Fund since the Fund was created on May 19, 1976:

	<b>Cumulative since 1976</b>	
	<b>2012</b>	<b>2011</b>
<b>Accumulated net income</b>	<b>\$ 32,104</b>	<b>\$ 31,306</b>
<b>Transfers to the Fund</b>		
Resource Revenue (1976-1987)	12,049	12,049
Access to the Future <sup>(a)</sup>	1,000	1,000
Voted Payments	2,918	2,918
	<u>15,967</u>	<u>15,967</u>
<b>Transfers (from) the Fund</b>		
Section 8(2) transfers <sup>(b)</sup>		
Income	(32,309)	(31,511)
Amount Retained for Inflation-proofing	2,376	1,922
	<u>(29,933)</u>	<u>(29,589)</u>
Capital Expenditures (1976-1995) <sup>(c)</sup>	(3,486)	(3,486)
	<u>(33,419)</u>	<u>(33,075)</u>
<b>Net financial assets, at cost</b>	<b>\$ 14,652</b>	<b>\$ 14,198</b>
<b>Net financial assets, at fair value</b>	<b>\$ 16,092</b>	<b>\$ 15,190</b>

<sup>(a)</sup> Section 9.1 of the *Alberta Heritage Savings Trust Fund Act* (the Act) and Section 4(5) of the *Access to the Future Act* provides that up to \$3 billion may be transferred from the GRF to the fund,

<sup>(b)</sup> During the year, the Fund earned net income of \$798 million of which, \$454 million was retained in the Fund for inflation proofing and \$344 million is payable to the General Revenue Fund. Section 8(2) of the Act states that the net income of the Heritage Fund less any amount retained in the Fund to maintain its value, in accordance with section 11(1), shall be transferred to the GRF annually in a manner determined by the Minister of Finance. If the income of the Fund is less than that required to be retained, then the income, if any, shall be retained in the Fund. The estimated amount retained from income of the Fund is determined by multiplying the total equity of the Fund before the amount retained for inflation-proofing by the estimated percentage increase in the Canadian gross domestic product implicit price index (GDP Deflator Index) for the year. In accordance with section 11(3), if the GDP Deflator Index is a negative number, that negative number shall be treated as if it were zero.

<sup>(c)</sup> Capital expenditures include transfers of \$300 million to the Alberta Heritage Foundation for Medical Research in 1980 and \$100 million to the Alberta Heritage Scholarship Fund in 1981.

**NOTE 6 INVESTMENT INCOME (in millions)**

The following is a summary of the Fund's investment income by asset class:

	2012	2011
<b>Interest-bearing securities</b>	<b>\$ 275</b>	<b>\$ 259</b>
<b>Equities</b>		
Canadian	41	288
Global	319	409
Private	44	52
	<b>404</b>	<b>749</b>
<b>Inflation sensitive and alternative investments</b>		
Real estate	205	106
Infrastructure	(1)	29
Timberland	9	2
Private debt and loan	4	-
Inflation sensitive real return bonds	1	7
	<b>218</b>	<b>144</b>
	<b>\$ 897</b>	<b>\$ 1,152</b>

Investment income is comprised of income earned from investments in units of pooled funds which are created and managed by AIMCo.

The investment income for the year ended March 31, 2012 includes writedowns totalling \$271 (2011: \$54).

**NOTE 7 INVESTMENT EXPENSES (in millions)**

	2012	2011
Interest-bearing securities	\$ 5	\$ 3
Equities	63	45
Inflation sensitive and alternative investments	22	17
Investment administration expenses	9	7
<b>Total Investment Expenses</b>	<b>\$ 99</b>	<b>\$ 72</b>
Average fair value of investments	<b>\$ 15,951</b>	<b>\$ 14,915</b>
Per cent of investments at average fair value	<b>0.62%</b>	<b>0.48%</b>

Investment expenses and services are provided by AIMCo. It provides the day-to-day investment services for the Fund's investment portfolio. However, in order to achieve greater diversification, access external expertise and specialized knowledge and to reduce operational complexity, some investments are managed by third party investment managers selected and monitored by AIMCo.

Investment expenses are recognized on an accrual basis and include those costs and fees incurred to earn investment income by the Fund. The Fund recognizes portfolio management and administration expenses incurred directly by the Fund and its share of expenses through pooled investment funds.

Investment services provided by AIMCo are charged directly to the Fund and to pooled funds on a cost recovery basis. Investment services provided by external managers are charged to pooled funds based on a percentage of net assets under management at fair value, or committed amounts. Fees charged by external managers include primarily regular management fees and performance/incentive based fees to the extent recognized.

Investment services include daily trading of securities, portfolio research and analysis, custody of securities, valuation of securities, performance measurement, maintenance of investment systems and internal audit. Alberta Finance provides investment accounting, reporting and treasury management services for the Fund. A portion of these costs are charged to the Fund.

#### **NOTE 8** INVESTMENT PERFORMANCE (net of investment expenses)

Estimated investment returns are provided as supplementary information. The determination of the estimated return is based on fair values using quoted market prices and estimates of fair value where no quoted market prices are available. The estimated return includes gains and losses that have not been realized. Estimated benchmark returns are based on published market-based indices and estimates where no published index is available.

Time-weighted rates of return, at fair value <sup>(a)</sup>	2012	2011 restated <sup>(d)</sup>	Average Annualized Return	
			5 years	10 years
Estimated return <sup>(b)</sup>	8.2%	10.4%	2.7%	5.7%
Estimated policy benchmark return <sup>(b)</sup>	5.6%	9.6%	2.9%	5.3%
Value added (lost) by investment manager <sup>(c)</sup>	2.6%	0.8%	-0.2%	0.4%

<sup>(a)</sup> The time-weighted rate of return involves the calculation of the return realized by the Fund over a specified period and is a measure of the total proceeds received from an investment dollar initially invested. Total proceeds include cash distributions (interest and dividend payments) and capital gains and losses (realized and unrealized).

<sup>(b)</sup> Investment returns are provided by AIMCo. The overall return and benchmark is based on investment returns and benchmarks for each asset class. Investment returns for assets classified as real estate, private equities, infrastructure, hedge funds and private debt are based on estimates of fair value. For these investments, measurement uncertainty exists because trading activity is infrequent and fair values are derived using valuation techniques which incorporate assumptions that are based on non-observable market data. Reasonably possible alternative assumptions could yield an increase or decrease in the fair value amounts and investment returns reported for these types of investments. Any change in estimated returns, resulting from new information received after the cut-off date for preparation of the Fund's financial statements, will be reflected in the next reporting period.

<sup>(c)</sup> In the *Statement of Investment Policies and Guidelines*, the Minister of Finance expects that the investments held by the Fund will return approximately 100 basis points, or 1% per annum, above the policy benchmark.

<sup>(d)</sup> The benchmark return reported for 2011 has been restated to conform with changes made by AIMCo subsequent to the completion of the 2011 financial statements. As a result, the benchmark return changed from 9.4% to 9.6%.

#### **NOTE 9** COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the 2011-12 presentation.

#### **NOTE 10** APPROVAL OF FINANCIAL STATEMENTS

The Deputy Minister of Treasury Board and Finance approved these financial statements.

## **GLOSSARY**

### **ABSOLUTE RETURN STRATEGIES**

Absolute Return Strategies (Hedge Funds) encompass a wide variety of investments with the objective of realizing positive returns regardless of the overall market direction. A common feature of many of these strategies is buying undervalued securities and selling short overvalued securities. Some of the major types of strategies include long/short equity, fixed income arbitrage, merger arbitrage, macroeconomic strategies, convertible arbitrage, distressed securities and short selling.

### **ACCRUAL ACCOUNTING**

An accounting method that recognizes income when it is earned and expenses when they are incurred, rather than when they are received or paid.

### **ACTIVE STRATEGIES**

The strategies have two forms - security selection or market timing. Security selection is the buying and selling of securities to earn a return above a market index such as the S&P/TSX Index for Canadian Stocks. Market timing is based on shifting asset class weights to earn a return above that available from maintaining the asset class exposure of the policy asset mix.

### **ASSET MIX**

The percentage of an investment fund's assets allocated to major asset classes (for example 50% equities, 30% interest-bearing securities and 20% inflation sensitive and alternative investments).

### **BENCHMARK**

A standard against which actual returns are measured. For the purposes of this report, benchmarks are established income indices used to measure the health of the Fund's investment income.

### **BOND**

A financial instrument showing a debt where the issuer promises to pay interest and repay the principal by the maturity date.

### **CAPITAL GAIN**

The market value received on sale of an asset beyond its cost or purchase price. If the asset is bought for \$50 and sold for \$75, the realized capital gain (profit) is \$25.

### **COST VALUE**

The value for which an asset was acquired.

### **CREDIT RISK**

The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

### **CURRENCY RISK**

The risk that the fair values or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

### **DEPOSITS**

Liquid, short-term investments. A cash equivalent.

### **DERIVATIVE CONTRACT**

Financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates.

### **DIVERSIFICATION**

Spreading investments to reduce risk by buying different securities from various companies, businesses, locations and governments.

**EMERGING MARKET**

An economy in the early stages of development whose markets have sufficient size and liquidity and are receptive to foreign investment.

**EQUITY**

Stocks; the ownership interest in a company.

**EXTERNAL MANAGER**

A third-party firm contracted to provide investment management services.

**FAIR VALUE**

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act. Fair value is similar to market value.

**FRONTIER MARKETS**

Equity markets in smaller and less accessible developing countries. These pre-emerging markets are typically pursued by investors seeking high long-term return potential.

**GENERAL REVENUE FUND (GRF)**

The central operating account for the Province of Alberta. It is where most of the revenues received by the Province are deposited and from where most of the expenditures are made.

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)**

These are accounting guidelines formulated by the Canadian Institute of Chartered Accountants (CICA) Accounting Standards Committee (ASC), that govern how businesses and governments report their financial statements to the public. The recommendations of the Public Sector Accounting Board (PSAB) of the CICA are the primary source for the disclosed basis of accounting.

**GLOBAL DEVELOPED MARKET**

The global developed market is used to describe countries whose economies and capital markets are well established and mature.

**INFLATION**

Increases in the general price level of goods and services. Inflation is one of the major risks to investors over the long-term as savings may actually buy less in the future.

**INTEREST-BEARING SECURITIES**

Interest bearing investments such as bonds and debentures, and money market investments such as treasury bills and discount notes (see "Bond" and "Money Market Security").

**INTEREST RATE RISK**

The risk that the fair value of future cash or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

**INVESTMENT PORTFOLIO**

A pool of securities held as an investment. Holdings of a diverse group of assets by an individual company or fund.

**LARGE CAP**

Investment in larger capitalized firms. Within Canada, companies with a market capitalization of greater than 0.15% of the total Toronto Stock Exchange market capitalization.

**LIQUIDITY**

The ease with which an asset can be turned into cash and the certainty of the value it will obtain.

**LIQUIDITY RISK**

The risk that a government fund will encounter difficulty in meeting obligations associated with financial liabilities.



**LONG BONDS**

Generally includes bonds with terms to maturity of greater than ten years.

**MARKET VALUE**

See fair value.

**MARKET (VALUE) RATE OF RETURN**

The market value rate of return measures income (interest and dividends) and capital appreciation or depreciation (realized and unrealized). The method used to calculate the return is the time-weighted method.

**MARKETABLE SECURITY**

An investment for which there is usually a ready market.

**MODIFIED DURATION**

A measure of price volatility of fixed income securities (i.e. bonds). It is the weighted average term-to-maturity of the security's cash flows (i.e., interest and principal). The greater the duration of a bond, the greater its percentage price volatility.

**MONEY MARKET SECURITY**

An interest bearing security such as treasury bills or corporate paper that matures within one year from the date of acquisition.

**NET INCOME**

The amount of earnings remaining after deducting expenses.

**NET INVESTMENT INCOME**

On a cost basis, includes realized capital gains, interest, dividends, security lending income, derivative income and administrative expenses. On a fair value basis, includes in addition to the above, current period changes in unrealized gains and losses.

**NOMINAL RATE OF RETURN**

A measure of return that does not exclude the effect of inflation (see Real Rate of Return).

**PAR VALUE**

A value set as the face or principal amount of a security, typically expressed as multiples of \$100 or \$1,000. Bondholders receive par value for their bonds at maturity.

**PASSIVE STRATEGIES**

These strategies involve investing to replicate the performance of a given market index such as the S&P/TSX Composite Index for Canadian stocks, or managing asset class exposure to match the performance of an established policy asset mix.

**POOLED FUND**

A fund in which money from two or more investors is accepted for investment and where units allocated to each investor serve to establish the proportionate interest at any time of each investor in the assets of the Fund.

**PRICE RISK**

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

**REAL RETURN BOND**

A interest-bearing security (i.e. bond) that generates a specified real rate of return. The real interest rate is the nominal (set) interest rate minus inflation.



**REAL VALUE OR REAL RATE OF RETURN**

A measure of value or return after accounting for inflation. It is equal to the nominal value or return less an amount for inflation.

**REALIZED AND UNREALIZED**

Terms generally used to describe capital gains or losses. A gain or loss is realized when the asset is sold; if to sale the gain or loss is unrealized and it is only a potential gain or loss.

**SWAP**

A financial agreement whereby counter parties agree to exchange the returns they earn on their respective assets. An investor might swap the return from his floating rate note portfolio for the return of a major equity index like the Standard and Poor's Toronto Stock Exchange.

**SECURITY**

Any investment instrument such as a bond, common stock, deed of trust on property, or any evidence of indebtedness or equity.

**SHORT-TERM INVESTMENT**

An investment with a maturity date of less than one year.

**SHORT SELLING**

A sale of securities not owned at the time of sale anticipating the price to fall and the securities to be repurchased at a profit. Short selling involves borrowing equivalent securities for delivery to a buyer and eventually buying the securities to return to the lender.

**SMALL CAP**

Investment in smaller capitalized firms. Within Canada, companies with a market capitalization of less than 0.15% of the total Toronto Stock Exchange market capitalization.

**TERM-TO-MATURITY**

The number of years left until a bond matures.

**TIME-WEIGHTED RATE OF RETURN**

Time-weighted rate of return are designed to eliminate the effect that the size and timing of cash flows has the internal rate of return since the pattern of cash flows vary significantly among funds. The investment industry uses time-weighted rates of return when comparing the returns of one fund to another fund or to a index.

**VOLATILITY**

In financial matters, volatility of returns is the measurement used to define risk. The greater the volatility, the higher the risk.

Alberta ■